

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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PLR-145359-08

Date:

December 30, 2008

LEGEND:

Distributing =

Controlled =

Corp. A =

State =

Year 1 =

Year 2 =

Business A =

Location A =

Business B =

Location B =

Shareholder A =
Family

Shareholder B =
Family

e =

f =

Dear :

This letter responds to your representative's October 14, 2008, letter requesting rulings as to the Federal income tax consequences of proposed transactions. The material information submitted in that letter and subsequent correspondence is summarized below.

The rulings contained in this letter are based upon facts and representations that were submitted on behalf of the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding: (i) whether the distribution described below satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii)

whether the distribution is used principally as a device for the distribution of the earnings and profits of the distributing company or the controlled company or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d) of the regulations); and (iii) whether this distribution is part of a plan (or a series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent (50%) or greater interest in Distributing or Controlled (see § 355(e) of the Code and § 1.355-7 of the regulations). In addition, no opinion is expressed as to the tax consequences of any matter involved in either of the other transactions described below, including: (i) whether any of the loans described below constitute valid debt for federal income tax purposes; (ii) whether any property received by the shareholders in the related redemption, including cash or notes, should be treated as a distribution under section 301 or a redemption to which section 302 applies. Furthermore, no opinion is expressed as to the validity of any S corporation election of either Distributing or Controlled.

SUMMARY OF FACTS

Distributing is a closely held State corporation that uses the accrual method of accounting and a calendar year. Distributing was incorporated in Year 1 as a subchapter C corporation but converted to an S corporation in Year 2 (more than 10 years ago). Distributing is engaged in Business A and Business B. Distributing has outstanding e shares of common stock (and no other stock), all of which stock is held 50 percent by Shareholder A Family and 50 percent by Shareholder B Family.

Controlled is being formed as a State corporation and will elect to be treated as an S corporation for federal income tax purposes. Controlled will use the accrual method of accounting and a calendar year. Controlled will have outstanding one class of stock which, initially, will all be held by Distributing.

Shareholder A Family and Shareholder B Family desire to operate Business A and Business B in separate entities in order to resolve personnel matters and to enable each business to focus on its own coherent business strategy. To achieve this separation, Distributing will transfer Business B to Controlled in exchange for all the stock in Controlled and then will distribute all the Controlled Stock to Shareholder B Family in exchange for their shares of Distributing. The businesses will be operated at separate locations with Business A being operated at Location A and Business B being operated at Location B.

The members of Shareholder A Family and Shareholder B Family are also the primary shareholders of Corp. A. In connection with the proposed transaction discussed below, Corp. A will redeem the stock of Shareholder A Family in order to allow the families to separate their interests.

Financial information submitted by Distributing indicates that each of both Distributing's Business A and Distributing's Business B has had gross receipts and

operating expenses representative of the active conduct of a trade or business for each of the past 5 years.

PROPOSED TRANSACTION

In order to achieve the objectives discussed above, Distributing proposes the following transaction:

1. To facilitate the redemption of Shareholder A Family's stock in Corp. A, Distributing will make a loan to the Shareholder B Family who will then make a loan to Corp. A.
2. Corp. A. will redeem all of its stock held by the Shareholder A Family for a redemption amount (the "Redemption Amount") based on current financials and an agreed value of \$f. The Redemption Amount will include amounts received by Corp. A in Step 1. Subsequent to this transaction, all the stock in Corp. A will be held by the Shareholder B Family.
3. Distributing will borrow approximately \$f from a lending institution and members of the Shareholder A Family. Distributing will contribute the loan proceeds to Controlled in Step 4.
4. Distributing will transfer to Controlled the assets of Business B (including real property and equipment) and liabilities associated with Business B, and also, as necessary to even values, the cash borrowed in Step 3, in exchange for all of the stock in Controlled (the "Contribution").
5. Distributing will distribute to the Shareholder B Family all of the Controlled Stock in exchange for all of their Distributing Stock (the "Distribution").
6. Controlled will make an election under § 1362(a) to be treated as an S corporation (within the meaning of § 1361(a)).

REPRESENTATIONS

Distributing has made the following representations in connection with the proposed transactions:

- (a) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing equals or exceeds the sum of the liabilities to be assumed (within the meaning of § 357(d)) by Controlled plus any liabilities to which the transferred assets were subject.
- (b) The liabilities to be assumed (within the meaning of § 357(d)) by Controlled in the transaction and the liabilities to which the assets transferred from Distributing to

Controlled are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

- (c) Distributing neither accumulated its receivables nor made an extraordinary payment of its payables in anticipation of the transaction.
- (d) No intercorporate debt will exist between Distributing and Controlled at the time of or subsequent to the proposed distribution of Controlled stock by Distributing.
- (e) No parties to the transaction are investment companies as defined in section 368(a) (2)(F)(iii) and (iv).
- (f) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee or in any capacity other than as a shareholder of Distributing.
- (g) The fair market value of Controlled's stock to be received by the shareholders will be approximately equal to the fair market value of Distributing stock surrendered by those shareholders in the exchange.
- (h) The aggregate fair market value of the assets transferred to Controlled in the contribution will equal or exceed the aggregate adjusted basis of these assets. Section 362(e)(2).
- (i) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statement submitted.
- (j) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to the consummation of the transaction.
- (k) The distribution of stock of Controlled is carried out for the corporate business purpose of settling and resolving irreconcilable disputes between two groups of shareholders/directors of the distributing corporation, by giving each group of the shareholders/directors control and ownership of separate businesses of the distributing corporation. The distribution of Controlled stock is motivated, in whole or substantial part, by that corporate business purpose.
- (l) For purposes of section 355(d), immediately after the distribution, no person (determined by applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote or 50 percent or more of the total value of shares of all classes of

Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the distribution.

- (m) For purposes of section 355(d), immediately after the distribution, no person (determined by applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock, that was (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchases (as defined in section 355(d)(5) and (8) during the five-year period (determined after applying section 355(d)(6)) ending on the date of distribution.
- (n) The distribution is not a part of a plan or series of related transactions (within the meaning of § 1.355-7), pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (o) The transaction is not used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both. See § 355(a)(1)(B).
- (p) Distributing, Controlled, and each of the shareholders will each pay his, her, or its own expenses incurred in connection with transaction.
- (q) Neither Distributing nor Controlled will be a disqualified investment corporation within the meaning of section 355(g)(2) of the Code.

RULINGS

Based solely on the information submitted and the representations set forth above, we rule as follows:

1. The Contribution followed by the Distribution (as described respectively in steps 4 and 5 above) will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be a party to the reorganization within the meaning of § 368(b) of the Code.
2. No gain or loss will be recognized by Distributing upon its receipt of Controlled corporation stock in exchange for the transfer of assets to Controlled and the assumption of liabilities by Controlled. Sections 361(a) and 357(a) of the Code.

3. No gain or loss will be recognized by Controlled upon its receipt of assets in exchange for the issuance of shares of Controlled stock. Section 1032(a).
4. Controlled's basis in each of the assets received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction. Section 362(b).
5. The holding period for each asset received by Controlled from Distributing will include the period during which such asset was held by Distributing. Section 1223(2).
6. No gain or loss will be recognized to Distributing on the distribution of stock to the Shareholder B Family in the distribution. Section 361(c)(1).
7. No gain or loss will be recognized to (and no amounts will be included in the income of) the Shareholder B Family upon their receipt of Controlled stock in exchange for their Distributing stock. Section 355(a)(1)
8. The basis of the Controlled stock in the hands of Shareholder B Family will be the same as the basis of the Distributing stock surrendered in exchange therefore. Section 358(a)(1).
9. The holding period of the Controlled stock received by the Shareholder B Family will include the holding period of the Distributing stock surrendered in exchange, provided that the Distributing stock is held as a capital asset on the day of the distribution. Section 1223.
10. Distributing's earnings and profits will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. § 1.312-10(a).
11. The accumulated adjustments account of Distributing will be allocated between Distributing and Controlled in a manner similar to the manner in which the earnings and profits of distributing will be allocated under section 312(h) (see Treas. Reg. § 1.312-10(a) and Treas. Reg § 1.1368-2(d)(3)).
12. Provided that the Distribution is undertaken immediately after the Contribution, Distributing's momentary ownership of the stock in Controlled, as part of the reorganization under section 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B) and will not, in itself, render Controlled ineligible to elect to be an S corporation for its first taxable year.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any matter or item discussed or

referenced in this letter. Moreover, no opinion is expressed about the tax treatment of the transactions or of any other matter under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions not specifically covered by the above rulings. In particular as provided above, no opinion is expressed regarding: (I) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (II) whether the Distribution is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Code and § 1.335-2(d) of the regulations); and (III) whether the Distribution is part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii). In addition, no opinion is expressed as to the tax consequences of any matter involved in steps 1-3 above, including: (i) whether any of the loans described above constitute valid debt for federal income tax purposes; (ii) whether any property received by Shareholder A Family in the redemption, including cash or notes, should be treated as a distribution under section 301 or a redemption to which section 302 applies. Furthermore, no opinion is expressed as to the validity of any S corporation election of either Distributing or Controlled.

PROCEDURAL STATEMENTS

This private letter ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) of the Code provides that this private letter ruling may not be used or cited as precedent.

It is important that a copy of this letter be attached to the Federal income tax returns of each taxpayer involved for the taxable year(s) in which the transactions are consummated. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching to the return a statement that provides the date and control number (PLR-145359-08) of this ruling letter.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representative.

Sincerely,

Debra L. Carlisle

Debra L. Carlisle
Chief, Branch 5
Office of Associate Chief Counsel
(Corporate)